PREFATORY NOTE

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Federal Open Market Committee

Conference Call

June 5, 1989

PRESENT: Mr. Greenspan, Chairman
Mr. Angell
Mr. Guffey
Mr. Johnson
Mr. Kelley
Mr. LaWare
Mr. Melzer
Mr. Syron

Messrs. Boehne, Boykin, Hoskins, Oltman, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Black, Forrestal, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Fransciso, respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Assistant Secretary
Mr. Gillum, Deputy Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Truman, Economist

Messrs. R. Davis, Lindsey, and Simpson, Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account
Mr. Cross, Manager for Foreign Operations, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Ms. Zickler, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Keleher, Assistant to Governor Johnson, Office of Board Members, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Doyle, First Vice President, Federal Reserve Banks of Chicago

Messrs. Broaddus, Lang, Rolnick, Rosenblum, Scheld, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of Richmond, Philadelphia, Minneapolis, Dallas, Chicago, and Atlanta, respectively

Transcript of Federal Open Market Committee Conference Call of June 5, 1989

CHAIRMAN GREENSPAN. Good afternoon, everyone. I believe we are all accounted for with the exception of Governor Heller who is away. Sam Cross, could you bring us up to date on anything pending?

MR. CROSS. Yes sir, Mr. Chairman. [Statement--not transcribed.]

CHAIRMAN GREENSPAN. Thank you, Mr. Cross. Any questions for Mr. Cross? Peter Sternlight, would you update us?

MR. STERNLIGHT. Certainly, Mr. Chairman. [Statement--not transcribed.]

CHAIRMAN GREENSPAN. Joyce Zickler, could you bring us up to date on your appraisal of the Friday [employment] report?

MS. ZICKLER. [Statement--not transcribed.]

CHAIRMAN GREENSPAN. Any questions for Ms. Zickler?

MR. BLACK. Mr. Chairman, this is Bob Black. Has anybody been able to figure out whether this is a supply phenomenon or a demand phenomenon? It occurs to me, with this high level of employment, that that weakness might stem from a lack of people to employ.

CHAIRMAN GREENSPAN. I'm sorry, I didn't quite get what the meaning of your question was.

MR. BLACK. Well, [I question whether] to interpret this as a sign of weak demand when employment rose so slowly. I'm wondering if it wasn't a matter of difficulty in finding people, given such a high level of employment, high participation rates, and a relatively low level of unemployment.

MR. JOHNSON. That shows up in the [index for] wages, Bob.

MR. BLACK. I didn't understand all of what Joyce was saying, but I thought it had accelerated a little.

MR. JOHNSON. No, it went down.

MS. ZICKLER. Well, on a year-over-year basis there really hasn't been much acceleration in the hourly earnings index. For the last year or so we've been seeing quarterly numbers that fluctuate anywhere from 3 to 4 percent. And, as Governor Johnson just said, if we were continuing to get more and more widespread shortages we would expect to see more on the wage side. We had thought that perhaps some of that supply constraint was showing up in the productivity numbers. But I'm not certain we'd be ready to give that interpretation to it right now.

CHAIRMAN GREENSPAN. There is clearly a puzzle as to why the wage behavior is as soft as it is, given the tightness of the labor markets. I guess the only thing that one can conclude from any of this is that the issue of job security, which surfaced as a critical element several years ago, appears to be as pronounced as it has been. One sees it as a significant shift in the relationships between wages and the unemployment rate. The data that we saw in Friday's report I found frankly rather encouraging, in the sense that if there were acceleration going on we would have seen it in that figure. As best I can judge, the fact that it came down rather than going up reinforces the view that wage pressures are, if anything, subdued rather than accelerating. Mr. Kohn, would you bring us up to date and also respond to the request of President Parry of last week?

MR. KOHN. [Statement--not transcribed.]

CHAIRMAN GREENSPAN. Are there any questions for Mr. Kohn?

MR. PARRY. Don, this is Bob Parry. Thank you very much for doing that work. One question: On your assumption that M2 would end up near the bottom end of the range, what was the assumption with regard to [interest] rates for the remaining part of the year?

MR. KOHN. The assumption was that they would rise from where there were last time by about 3/4 of a point by the fourth quarter.

MR. PARRY. So, if [interest] rates were to stay where they are or even decline somewhat, money growth could be somewhat faster?

MR. KOHN. That's true. Offsetting that, President Parry, was the fact that the incoming data were a little weaker, and carried forward this [would affect] our view of nominal GNP. We already have had a downward revision to the first quarter so that in some sense nominal GNP could be a bit on the weaker side. So, we weren't going to have a major revision. But you're right--the [steady] interest rates work in the direction of higher money growth.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. Any other questions for Mr. Kohn? As I indicated last week, I was concerned about how the data would come out on Friday's employment report--if they would show no contrary evidence to what was beginning to emerge very clearly as a significant defusing of inflationary pressures. Increasingly, as I look at commodity prices, and especially wages, I would be inclined to request the Desk to bring down the borrowing requirement a notch. I've concluded--looking at the data and thinking about it considerably over the weekend--that that is the appropriate thing to do. Hence, consistent with the directive, I am requesting the Desk to move the borrowing objective from $600 million down to $500 million; and I expect that to be consistent with a funds rate of about 9-1/2 to 9-5/8 percent. Is there any discussion?

MR. GUFFEY. Mr. Chairman, Roger Guffey.

CHAIRMAN GREENSPAN. Yes, Roger.

MR. GUFFEY. You have made your proposal and it does encompass a lower interest rate level. I understand that, I think. I really believe the data that we look at can be read both ways. But I don't really understand the urgency of moving at this time given the uncertainty about inflation and the uncertainty about the strength of the economy generally. It still isn't clear to me that we're in anything other than a pause. As a result, there seems to me to be some risk of this economy really [unintelligible] in the period ahead and having to reverse our stance.

CHAIRMAN GREENSPAN. Well, I wouldn't disagree with that, Roger. At this particular point we are confronted with a very tricky balancing of risks. Essentially, the question here is: Is the risk of being wrong in moving down modestly larger? I might add, given the money supply growth factors, which we discussed at length last week: Are we at greater risk with our money supply and inflation outlook data than we are on the dangers of reacceleration? I think that this is a close call; I would not deny that. However, having looked at the [forward] order positions in the best detail that I could and having spoken to the purchasing managers in some considerable detail--even going beyond the data that were published in the May purchasing managers' report--the impression I am getting is that all the preliminary indications are that their next report will be one of increasing softness on the inflation side. I would think that that in itself would not be enough if there were not also evidence that the wage patterns are being subdued. If we had complete capability of seeing into the future this would be an easy job, but we obviously don't have that. And I must tell you that I do not see immediate signs of deterioration. The inventory data at this stage don't show any imbalances that create major problems. My major concerns are (1) the money supply data and (2) evidence that is emerging that the commodity price inflation is beginning to subdue. All the discussions that I have been able to have--and there have been a considerable number of them--confirm that the inflationary processes are easing, not accelerating.

MR. PARRY. Mr. Chairman, this Bob Parry.

CHAIRMAN GREENSPAN. Yes, Bob.

MR. PARRY. It seems to me important that we indicate that we'd like to chart some longer-term [course] for a lower rate of inflation. Quite frankly, I don't think that a small decline in interest rates such as the one that you're proposing would be at variance with that necessarily. If we were to make the change that you've suggested, perhaps at some convenient opportunity you could underline the concerns that we all have about gradually reducing the rate of inflation over the longer term. I think it would be a very desirable way to go.

CHAIRMAN GREENSPAN. Well, in the Humphrey-Hawkins testimony we will update our basic views with respect to the P* forecast system and emphasize that the purpose of our policy is to bring the inflation rate down to negligible levels--as close to zero or thereabouts as possible.

MR. ANGELL. Mr. Chairman, I certainly support your move. It seems to me that we do not always know whether the given level of restraint is in place or not. And when we begin to have undershoots in regard to money, it just seems to me that it's the prudent thing to do to let some of that show through on the interest rate side so that all of the miss doesn't show up on the reserve side. I have never seen a clearer signal in regard to money growth--also incorporated by turning commodity prices and foreign exchange auction markets as well as the action of the bond market--that would indicate such a clear view as to what seems to be happening. Now, I will grant that these money numbers may change, and commodity prices may change, and foreign exchange markets may change. But if all of these were to transpire, Mr. Chairman, I would be just as eager to be out front in supporting a reversal or a continuation of what was there as I am to support this. I believe this is an appropriate move.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. Yes, I would like to back up what Governor Angell said and also acknowledge what Bob Parry said. I see this as an appropriate move and not at all inconsistent with our long-term goal of getting the inflation rate down. I think we can easily make the mistake of seeing the fed funds rate and the level of short-term interest rates as a target and not an instrument. I thought we all basically had taken the position in the past that we don't want to target the level of short-term interest rates--that we see movements in interest rates rather as an instrument of our long-run goals. If that is the case, there are going to be times when we see the funds rate come under both downward pressure and upward pressure. I don't see having to reverse this at some point--if in fact that's the way things develop--as inconsistent at all. I think it would be a much worse mistake simply to worry about stabilizing the level of interest rates and to view any change from that level as a tightening or easing of policy. I don't think it is at all.

CHAIRMAN GREENSPAN. Any further comments? Governor Seger.

MS. SEGER. I support your move for the reasons listed by Governor Johnson and also Governor Angell; I agree with all of those.

CHAIRMAN GREENSPAN. Anything further?

MR. GUFFEY. Mr. Chairman?

CHAIRMAN GREENSPAN. Yes.

MR. GUFFEY. Roger Guffey again. Let me say that I don't necessarily agree with the action you're proposing. Let me raise another point. The dropping of the borrowing level to $500 million, given that seasonal borrowing is now up at least to the $375 million level, leaves roughly only about $100-$125 million of adjustment borrowing, which is marginal it seems to me. If we're going to move this way, what you're really talking about is an interest rate target for the short run rather than a borrowing target. And I know the Desk would treat it [unintelligible]--

CHAIRMAN GREENSPAN. Well, that's an important point, Roger. Don Kohn, why don't you respond?

MR. KOHN. Well, President Guffey is correct in that seasonal borrowing has moved up--actually to $385 million in the current period. I would say, though, that we moved the borrowing objective up to $600 million at the last FOMC meeting sort of as a technical adjustment, mostly in anticipation of the increase in seasonal borrowing. So, while the Desk will have to remain somewhat flexible, I do think that the consistency of $500 million with federal funds trading in the 9-1/2 to 9-5/8 percent area is probably taken care of by the adjustment that the Committee made at its last meeting.

CHAIRMAN GREENSPAN. Any further questions? If not, I look forward to seeing you all at the next FOMC meeting of July 5.

END OF SESSION